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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1979

**No. 79-566**

LOUIS J. MARTINO AND McDONALD'S DRIVE-IN OF OTTUMWA, IOWA, INC.,

*Petitioners,*

*vs.*

McDONALD'S SYSTEM, INC. AND FRANCHISE REALTY INTERSTATE CORP.,

*Respondents.*

## BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI

EARL E. POLLOCK,
LOUIS C. KEILER,
ROBERT M. MARK,
*Attorneys for Respondents.*

SONNENSCHEIN CARLIN NATH & ROSENTHAL,
8000 Sears Tower,
Chicago, Illinois 60606,
(312) 876-8000
*Of Counsel.*

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## BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI

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Petitioners Louis J. Martino ("Martino") and McDonald's Drive-In of Ottumwa, Iowa, Inc. ("McDonald's of Ottumwa") seek review of the Court of Appeals' affirmance of the District Court's grant of summary judgment in favor of respondents McDonald's System, Inc. ("McDonald's") and Franchise Realty Interstate Corporation ("Franchise Realty") on Count I of petitioners' two-count complaint. None of the relevant considerations governing review on certiorari, as set forth in this Court's Rule 19, supports the grant of the requested writ. The decision of the Court of Appeals is wholly consistent with the pertinent decisions of this Court and the other Courts of Appeals. Nor does the decision below merit review by this Court for any other reason.

## QUESTION PRESENTED

An earlier action involving the same parties and the same contract provision was settled by entry of a consent decree and payment of $140,000 to petitioners. Subsequently, petitioners brought this action charging that respondents' enforcement of the contract provision by bringing the earlier action and obtaining the consent decree violated the antitrust laws.

The question presented is whether the Court of Appeals correctly held that petitioners, in the particular circumstances of this case, are barred under principles of *res judicata* from collaterally attacking the earlier decree and nullifying rights established in the earlier action.

## STATEMENT OF THE CASE

### The Franchise Agreement

Petitioners' action arises out of a franchise agreement authorizing petitioner Louis J. Martino and three of his brothers to operate a McDonald's restaurant owned by respondents and located in Ottumwa, Iowa.[1] Petitioners sold their interest in the Ottumwa restaurant in 1973 as part of a settlement of earlier litigation between the parties in the United States District Court for the Southern District of Iowa, *Franchise Realty Interstate Corporation and McDonald's System, Inc.* v. *Louis J. Martino, et al.*, No. 72-194-1.

Both the earlier litigation and Count I of the present complaint involve the same provision of the McDonald's franchise agreement for the Ottumwa restaurant. This provision prohibited the acquisition by the franchisee or by a member of the

1. Subsequent to the grant of the franchise in June, 1962, the corporate petitioner, McDonald's of Ottumwa, allegedly was formed by the Martinos to operate the Ottumwa restaurant. Louis Martino is now the sole shareholder, officer and director of McDonald's of Ottumwa.

franchisee's immediate family of a financial interest in another competing self-service food establishment without the written consent of the franchisor.

**The Earlier Litigation**

In the earlier litigation, commenced in 1972, McDonald's sued to terminate the Ottumwa franchise based on Louis Martino's alleged violation of this provision of the franchise agreement. That litigation was concluded in September 1973 by entry of a consent decree as part of a settlement negotiated by the franchisees and McDonald's (App. A19, 432 F. Supp. at 504).[2] In the consent decree, signed by the parties and their respective counsel, the District Court made specific findings of fact and conclusions of law, including the following finding and conclusion:

> "[That] the defendant, Louis J. Martino, or a member of his immediate family, has violated the terms of the sublease and the franchise agreement by engaging in a business in which food and beverages are dispensed other than the location covered by the agreements without the prior consent of Franchise Realty or McDonald's System, and that such action constitutes a material breach of agreement sufficient to justify termination." (App. A6-A7, n. 8, 598 F. 2d at 1083 n. 8.)

The decree further provided that the parties had entered into an agreement for the sale of the property to a third party. Pursuant to this settlement, Martino, his brothers and McDonald's of Ottumwa (which was a signatory to the purchase and sale agreement) received $140,000 from the sale of the Ottumwa franchise (App. A2, 598 F. 2d at 1081).

The consent decree did not contain any reservation by the franchisees of any claim against McDonald's or Franchise Realty. Prior to the present suit, the consent decree was never

2. "App." refers to the Appendix (containing the decisions of the Court of Appeals and the District Court) included in the petition for certiorari.

challenged by Martino or any of his brothers. Nor has any attempt been made in the United States District Court for the Southern District of Iowa to vacate or amend the 1973 decree, which accordingly stands as a final binding judgment constituting an adjudication on the merits (App. A6-A7, 598 F. 2d at 1083).

**The District Court Proceedings in This Case**

On October 14, 1975, two years after the 1973 decree, the complaint in the present action was filed in the United States District Court for the Northern District of Illinois.

Count I charges that McDonald's enforcement of the contractual provision at issue in the prior litigation violated Section 1 of the Sherman Act, 15 U. S. C. § 1, and seeks damages allegedly resulting from the settlement of that litigation.[3] Count I (as amended), after referring to the earlier suit, the consent decree, the settlement, and the $140,000 payment (¶¶ 13-15), alleges that "[t]he unlawful termination *through legal proceedings* of plaintiff's business had a substantial impact on interstate commerce . . ." (¶ 16) and that the respondents had violated Section 1 of the Sherman Act by thus *"enforcing the provisions of the franchise agreement and the sub-lease . . ."* (¶ 17) (italics added).

On March 30, 1976, respondents moved to dismiss and for summary judgment on the ground, *inter alia,* that the plaintiffs were estopped and barred from maintaining this action by the consent decree entered in the prior lawsuit. The District Court granted the motion for summary judgment with respect to Count I of the complaint in its memorandum opinion dated May 18, 1977 (App. A15-A27, 432 F. Supp. 499).

The District Court based its decision on both the compulsory counterclaim rule set forth in Rule 13(a), F. R. Civ. P., and on

3. Count II, which remains pending in the District Court, charges an illegal tie-in with respect to plaintiffs' purchases of Coca-Cola while a McDonald's franchisee.

principles of *res judicata* apart from Rule 13(a). In reaching this conclusion the District Court held:

> "The Iowa consent decree necessarily rests on the provision which the plaintiff now challenges, and that judgment assumes its validity and enforcibility." (App. A20-A21, 432 F. Supp. at 504.)

The District Court further ruled that "neither [Rule 13(a) nor principles of *res judicata*] would permit a litigant to impair the rights established in an earlier action" (App. A26-A27, 432 F. Supp. at 507).

On October 20, 1977, petitioners moved for reconsideration of the District Court's order.[4] In a memorandum opinion dated March 6, 1978 (App. A29), the District Court denied the motion for reconsideration and, on petitioners' motion, entered final judgment in favor of the respondents as to Count I pursuant to Rule 54(b), F. R. Civ. P., finding that there was no just reason for the delay in the entry of such final judgment (App. A30).

**The Court of Appeals Decision**

On appeal, the Court of Appeals affirmed the District Court's decision on the basis of *res judicata*. The Court ruled that petitioners' claim was not precluded by Rule 13(a) because no answer had ever been filed by petitioners in the Iowa litigation (even though an answer was long overdue when the case was settled). However, the Court held that even apart from Rule 13(a) "[b]oth precedent and policy require that res judicata bar a counterclaim when its prosecution would nullify rights established by the prior action"( App. A9, 598 F. 2d at 1085).

This principle was held to be controlling since "Martino's claim . . . is a direct attack on the termination rights established in the earlier judgment" (*ibid.*). The Court of Appeals pointed out that the decree entered by the federal court in Iowa "was

4. The District Court's ruling that Count I was barred under *res judicata* was not among the matters petitioners asked the District Court to reconsider.

accompanied by judicial findings of fact and conclusions of law that go to the merits of the controversy" in that Martino's actions were found to be "a material breach of the agreements sufficient to justify termination" (App. A6, 598 F. 2d at 1083). Accordingly, the Court of Appeals held, "It is impossible to interpret this count as anything but a direct challenge to the outcome of the 1973 lawsuit" (App. A7, 598 F. 2d at 1084).

## ARGUMENT

At the outset, three significant facts concerning this case should be noted. *First,* not only does petitioners' present action attack the very contract provision which was the subject of the earlier action and the resulting consent decree, but more specifically their claim is that the enforcement of that contract provision by respondents' bringing and maintaining the earlier action violated the Sherman Act.

*Second,* as the courts below pointed out, the prior decree was not only squarely premised on the validity and enforceability of the very contract provision which petitioners now challenge as unlawful, but furthermore the decree specifically found that petitioners' actions constituted "a material breach of agreement sufficient to justify termination".

*Third,* petitioners' present antitrust argument—had it been raised and found meritorious—would have been a complete defense to enforcement of the contract provision and entry of the decree in the earlier action, "changing the outcome of the litigation" (App. A8, 598 F. 2d at 1084).

Nevertheless, it is petitioners' extraordinary position that they were perfectly free in the prior proceeding to consent to the decree and its specific findings, receive $140,000 as part of the settlement, say nothing about any antitrust objection to the contract provision or the suit, *and then—two years later in another federal district court—spring their antitrust attack on the earlier action and the consent decree.*

The decision below, rejecting that argument, is not in conflict with any decision of this Court. Nor is there any conflict between Circuits. Indeed, the only question presented by the decision below involves application of established principles to the particular circumstances of this case.

## I.

### The Decision Below Does Not Conflict with Any Decision of This Court or the Other Courts of Appeals.

In holding that the prior decree barred petitioners' collateral attack on the same contract provision and the earlier action, the Court of Appeals applied established principles, going back to this Court's decision in *Cromwell* v. *County of Sac*, 94 U. S. 351 (1876), which held that a judgment

> ". . . is a finality as to the claim or demand in controversy, concluding parties and those in privity with them, not only as to every matter which was offered and received to sustain or defeat the claim or demand, *but as to any other admissible matter which might have been offered for that purpose. . . . If such defenses were not presented in the action, and established by competent evidence, the subsequent allegation of their existence is of no consequence.* . . . [A] judgment estops not only as to every ground of recovery or defense actually presented in the action, but also as to every ground which might have been presented. . . ." (94 U. S. at 352, 353; italics added.)

See also, e.g., *Angel* v. *Bullington*, 330 U. S. 183, 193 (1947); *Aerojet-General Corp.* v. *Askew*, 511 F. 2d 710, 718 (5th Cir.), *cert. denied*, 423 U. S. 183 (1975).

Quoting this well-settled rule, and applying it to the particular facts of this case, the Court of Appeals pointed out that the *res judicata* effect of a judgment "comprises defenses, such as the alleged antitrust violation here, that were or might have been raised." (App. A8, 598 F. 2d at 1084.) More specifically, the Court of Appeals held that "Both precedent and policy re-

quire that res judicata bar a counterclaim when its prosecution would nullify rights established by the prior action." (App. A9, 598 F. 2d at 1085.)

Thus, for example, in *Chicot County Drainage District* v. *Baxter State Bank,* 308 U. S. 371 (1940), "a case similar in relevant respects to the one before us" (App. A9, 598 F. 2d at 1085), this Court held that a decree effecting a plan of readjustment of indebtedness, which resulted in a cancellation of certain bonds pursuant to the Readjustment Act of 1934, precluded a subsequent suit involving the same bonds which alleged that the Readjustment Act was unconstitutional. This Court held that the subsequent action was barred—even though the constitutional issue was not actually litigated in the earlier proceeding—because ". . . having failed to raise the question in the proceeding to which they were parties and in which they could have raised it and had it finally determined, [plaintiffs were not] privileged to remain quiet and raise it in a subsequent suit" (308 U. S. at 378).[5]

Numerous cases are to like effect—even where, as in *Chicot County,* the omitted defense was constitutional in nature. See, e.g., *Lovely* v. *Laliberte,* 498 F. 2d 1261, 1262-63 (1st Cir.), *cert. denied,* 419 U. S. 1038 (1974); *Coogan* v. *Cincinnati Bar Ass'n.,* 431 F. 2d 1209, 1211 (6th Cir. 1970); *Blankner* v. *City of Chicago,* 504 F. 2d 1037, 1042 (7th Cir. 1974), *cert. denied,* 421 U. S. 948 (1975). *A fortiori,* the same doctrine has been frequently applied to non-constitutional claims, e.g., *Aerojet-General Corp.* v. *Askew, supra* at 718; *Miller* v. *Meinhard-Commercial Corp.,* 462 F. 2d 358, 360-361 (5th Cir.

5. See also Restatement (Second) of Judgments § 56.1(2)(b) (Tent. Draft No. 1, 1973) which states that:

> "A defendant who may interpose a claim as a counterclaim in an action but fails to do so is precluded, after rendition of judgment in that action, from maintaining an action on the claim if . . . [t]he relationship between the counterclaim and the plaintiff's claim is such that successful prosecution of the second action would nullify the initial judgment or would impair rights established in the initial action."

1972); *Mitchell* v. *Village Creek Drainage District,* 158 F. 2d 475, 477-478 (8th Cir. 1946); *Moore* v. *Harjo,* 144 F. 2d 318, 322-323 (10th Cir. 1944).

Furthermore, *res judicata* principles have been applied to antitrust claims in the same manner as non-antitrust claims. See, e.g., *Norman Tobacco & Candy Co.* v. *Gillette Safety Razor Co.,* 295 F. 2d 362, 363-364 (5th Cir. 1961); *Engelhardt* v. *Bell & Howell Co.,* 327 F. 2d 30, 32 (8th Cir. 1964); *Becker* v. *Crown Central Petroleum Corp.,* 1977-1 Trade Cases ¶ 61,527 (D. Md. 1975), at 72,062; *Nash County Board of Education* v. *Biltmore Co.,* 1979-2 Trade Cases ¶ 62,846 (E. D. N. C. 1978) at 78,869, 78,873.

Petitioners' argument that the decision below is inconsistent with this Court's decision in *Mercoid Corp.* v. *Mid-Continent Investment Co.,* 320 U. S. 661 (1944), is fallacious. The Court of Appeals carefully considered the *Mercoid* case, and explained why it did not apply here (App. A11-A12, 598 F. 2d at 1086).

*Mercoid* involved an issue of patent misuse. In an earlier patent infringement action brought by Mid-Continent, the defendant (Smith) had not asserted a defense based on patent misuse. However, in the subsequent *Mercoid* case (involving a second infringement action brought by Mid-Continent), a different defendant (Mercoid) responded to the complaint by alleging that the plaintiff (Mid-Continent) had conspired with its licensee to unlawfully expand the patent monopoly to unpatentable products. In those circumstances, this Court declined to apply *res judicata* because of the strong public policy "which has led this Court in the past to withhold aid from a patentee in suits for either direct or indirect infringement where the patent was being misused" (320 U. S. at 670).[6]

By contrast, in the instant case: (1) no issue of patent misuse is involved here; (2) as the court below pointed out (App. A11-A12, 598 F. 2d at 1086), the present action was not brought by respondents or as a response to some new

6. Mr. Justice Roberts, joined by Justices Frankfurter, Reed and Jackson, dissented (320 U. S. at 675).

lawsuit brought by respondents; and (3) as the court below also pointed out, this "Court's res judicata analysis in *Mercoid* . . . was no different than ours here" (App. A11, 598 F. 2d at 1086). Unlike the present situation, the *Mercoid* case did not involve a collateral attack on the prior judgment that Mid-Continent's patent was valid and had been infringed. Such a judgment is not inconsistent with the assertion of a patent misuse claim since patent misuse does not invalidate a patent but (until "purged") merely prevents its enforcement even though the patent is valid and infringed. *Morton Salt Co.* v. *G. S. Suppiger Co.*, 314 U. S. 488, 492-93 (1942). Here, on the other hand, Martino's claim that McDonald's enforcement of the noncompetition clause in the franchise agreement violated the antitrust laws is a direct attack on the prior decree which "assumes [t]he validity and enforcibility" of the contract provision. Permitting assertion of such a claim now would clearly nullify rights determined in the earlier action and undermine a settlement resulting in a payment to petitioners of $140,000. (App A9-A11, 598 F. 2d at 1085.)

Thus, as the Court of Appeals held, *Mercoid* does not remotely establish a broad rule, as petitioners assert (p. 6), prohibiting application of *res judicata* to antitrust claims, and petitioners do not cite a single decision of any Court of Appeals so holding.[7] There is no conflict, either between Circuits or with any decision of this Court.

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7. The cases cited by petitioners as "following" *Mercoid* (p. 7, n. 2) involve a wholly separate issue—on which the Court of Appeals explicitly declined to express a view—whether *Mercoid* classifies all antitrust counterclaims as permissive counterclaims under Rule 13, F. R. Civ. P. Indeed, since the court below based its decision on *res judicata,* and not Rule 13, cases "following" *Mercoid* on Rule 13 cannot possibly be in conflict with the decision below.

Moreover, most of these cases, like *Mercoid,* involve patent misuse counterclaims in patent infringement cases and thus do not support any broad rule even with respect to Rule 13. See, e.g., *Beacon Theatres, Inc.* v. *Westover,* 359 U. S. 500, 508 (1959); *United States* v. *Eastport Steamship Corp.,* 255 F. 2d 795, 805 (2d Cir. 1958); *Switzer Bros., Inc.* v. *Locklin,* 207 F. 2d 483, 488 (7th Cir.), *cert. denied,* 347 U. S. 912 (1953). See also *Hancock Oil Co.* v. *Universal Oil Products Co.,* 115 F. 2d 45, 47 (9th Cir. 1940), *cert. denied,* 314 U. S. 666 (1941).

## II.

## Petitioners' Other Objections to the Decision Below Are Wholly Without Merit.

### A. A "Cause of Action", for the Purpose of Determining the Res Judicata Effect of a Judgment, Comprises Defenses Which Were or Could Have Been Raised.

As the Court below stated, "The well-settled rule for the purpose of determining the res judicata effect of a judgment is that a 'cause of action' comprises defenses, such as the alleged antitrust violation here, that were or might have been raised." (App. A8, 598 F. 2d at 1084, citing *Cromwell* and *Chicot County* cases, *supra.*) Similarly, Professor Moore points out that one of the tests used for this purpose is "whether 'there is such a measure of identity that a different judgment in the second [action] would destroy or impair rights or interests established by the first' judgment". 1B Moore's Federal Practice, ¶ 0.410[1], p. 1158 (2d ed. 1974).[8] By either standard, the present action and the omitted claim in the prior action constitute a single "cause of action" for *res judicata* purposes, whatever may be the appropriate terminology in other contexts.

Petitioners, however, engage in semantic sleight-of-hand by arguing that for some other purposes the present action and the omitted claim in the prior action may be regarded as different "causes of action" (Pet. pp. 8-9). No doubt this is true, as the Court below recognized (App. A8, 598 F. 2d at 1084), in the sense that the prior suit was brought as a breach of contract action and the present suit as an antitrust action. But that is scarcely controlling for purposes of *res judicata.* Thus, in the *Chicot County* case, as the Court below pointed out (App. A9-A10, 598 F. 2d at 1085), the complaints in the two lawsuits were similarly based on two different theories—i.e., a suit by a bondholder to recover on certain bonds, and a statutory proceeding instituted by the issuer of the bonds to effect a plan

8. See also Restatement, *supra,* footnote 5.

of readjustment of its indebtedness.[9] Nevertheless, this Court held that "all the elements necessary to constitute the defense of res judicata are present" and that "having failed to raise the question in the proceeding to which they were parties and in which they could have raised it and had it finally determined [the plaintiffs were not] privileged to remain quiet and raise it in a subsequent suit" (308 U. S. at 375, 378). In the instant case, as the Court of Appeals held (App. A9-A11, 598 F. 2d at 1085), the *Chicot County* case is indistinguishable and required the same holding here.

**B. Petitioners' Contention That Rule 13(a) Preempts the Res Judicata Doctrine Was Never Presented Below and Is Patently Invalid.**

In their petition for certiorari, petitioners for the first time contend that Rule 13(a), F. R. Civ. P., preempts *res judicata* and is solely determinative of whether a withheld counterclaim may be litigated in a subsequent action. As stated in *Miree* v. *DeKalb County, Georgia,* 433 U. S. 25, 33-34 (1977), "The fact that the asserted basis [for reversal] is so obviously an afterthought may be some indication of its merit, but since it was neither pleaded, argued nor briefed either in the District Court or in the Court of Appeals, [this Court should] not consider it."

Petitioners do not cite a single decision of this Court or any other court in support of their argument. Moreover, their argument is directly contrary to the Federal Rules Enabling Act. *Res judicata* is a substantive principle of federal law concerning the operation of judgments. E.g., *Angel* v. *Bullington,* 330 U. S. 183, 186-187 (1947); *Cleckner* v. *Republic Van and Storage Co., Inc.,* 556 F. 2d 766, 768-769 (5th Cir. 1977). As such,

9. Petitioners (Pet. p. 8) erroneously seize upon the same point made in the opinion below as evidencing recognition of two different "causes of action". Petitioners not only ignore the Court's statement of the "well-settled rule" (App. A8, 598 F. 2d at 1084) but also ignore the central point that "cause of action" is a variable term depending on the context and purpose.

it is a part of the substantive law which the Federal Rules of Civil Procedure must not "abridge, enlarge or modify." Federal Rules Enabling Act, 28 U. S. C. § 2072.

Petitioners would have the application of *res judicata* in the present case turn on the procedural technicality of whether an answer was filed in the earlier proceeding because Rule 13(a) refers to a "responsive pleading". According to petitioners' theory, they should be allowed to attack in a different court the decree which they consented to in the federal court in Iowa because the 1973 decree was entered without an answer having been filed in the earlier proceeding.

Petitioners offer no cogent reason why there must be uniformity between Rule 13(a) and *res judicata*. More specifically, they provide no reason why the filing of an answer should take precedence over the important public policy of respecting the finality of judgments and protecting those who justifiably rely on such judgments.

Furthermore, contrary to petitioners' argument, the Court of Appeals did not invent any new rules which have prejudiced petitioners. As pointed out above, the decision below is grounded on long-standing principles of *res judicata* going back over a century.

## CONCLUSION

Having collected $140,000 from the sale of the Ottumwa McDonald's unit as part of the settlement of the earlier litigation, while at the same time consenting to the finding that McDonald's was entitled to termination of the franchise, petitioners cannot now be allowed to assert in a different forum that the termination was wrongful and that they are entitled to more than the $140,000 which they received. Reduced to its basics, petitioners' argument is simply that they have a right to withhold a claim from litigation as a matter of convenience or inadvertence, even though their claim would nullify the decree entered by the Iowa federal court in 1973.

The decision below does not conflict with the applicable decisions of this Court or of the other Courts of Appeals. Nor does it involve any important issue of federal law which has not previously been settled by this Court. For these reasons, the petition for certiorari should be denied.

Respectfully submitted,

EARL E. POLLOCK,
LOUIS C. KEILER,
ROBERT M. MARK,
*Attorneys for Respondents.*

SONNENSCHEIN CARLIN NATH
& ROSENTHAL,
8000 Sears Tower,
Chicago, Illinois 60606,
*Of Counsel.*